United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

74-2697

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FOR THE SECOND CIRCUIT

AID AUTO STORES, INC.,

Plaintiff-Appellant,

—against—

HERBERT S. CANNON and CANNON, JEROLD & CO., INC.,

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

APPELLANT'S REPLY BRIEF

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Table of Authorities

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1. Defendant Cannon's argument is that he was and ought to be ignorant of the cover page as well as contents of a prospectus (Ex. 1) under which his firm Cannon, Jerold was the third largest underwriter. The cover page includes:

> ". . . (ii) a two-year consulting agreement between the Representative [i.e. Rittmaster, Lawrence and Co., Inc.] providing for (a) an aggregate fee of $44,000 payable upon the consummation of this offering and (b) the issuance . . . of non-transferable five-year warrants . . ."

This prospectus dated November 30, 1972 at pp. 14-15 and pp. 21-22 more fully describes the financial consultancy and the right to designate a director, set forth as notice to the world on the cover page.

No federal court could entertain a denial of knowledge by the third largest underwriter of additional compensation to and relationship with the lead underwriter.

Here it is argued, and was held below as a matter of law, that Cannon was automatically ignorant of what the world knew and what went to the heart of the underwriting, and that it was not even necessary for him to take the stand to deny knowledge.

2. When Cannon a week after the underwriting on December 5, 1972, had a "dinner meeting . . . to sort of bury the hatchet between Mr. Rittmaster and myself" he certainly knew that his former "partner" (A. 53) would soon be at least a *single* fiduciary as financial consultant to plaintiff AID. During the ensuing numerous meetings with both Rittmaster and Lawrence when the purchase of a certificate of deposit by AID was discussed simultaneously with unsecured personal loans to individuals Rittmaster and Lawrence, it strains credulity to the utmost to posit that Cannon did not have actual knowledge of his former "partner's" becoming a *double* fiduciary as director. Defendants' brief, p. 10, contents itself with stating there was no proof Cannon read the prospectus.

3. Exhibit 9 transmitted Cannon's personal check of $100,000 on the Chase Bank to

> Mcleod Dixon Trust Company
> Toronto Dominion Bank
> 2 Calgary Place
> 340 Fifth Avenue, Southwest
> Alberta, Canada

It is plain from the testimony (A. 163) that this advance "to the Canadian Bank [was] for the purpose of the charter".

Cannon did not deposit $100,000, or any other sum, in the Bahamas Bank.

What Cannon did was buy the bank—then the bank out of its *own* funds paid Cannon $100,000. Thus, it was and remains precisely accurate to state that "Cannon bought and milked a Bahamian bank—getting back his $100,000 purchase price out of the bank's own assets" (Appellant's Brief pp. 2, 5).

It is patently contrary to the record for defendants' brief to say . . . "loaned money to the bank" (p. 4); ". . . Cannon's one hundred thousand dollar advance was repaid by the Bank" (p. 7); ". . . that Cannon had once loaned money to the Bank, had been repaid" (p. 24); "advanced a loan to the Bank, was repaid" (p. 28).

Cannon's funds ". . . for the purpose of the Charter" (A. 163) were exactly that—and he promptly got all his bait back. Cannon's own testimony tells us—we are not left to wonder, nor was the jury left to wonder had it been permitted to act, whether a quickie in-and-out deposit in the bank would so move the generous impulses of Mr. Schweitzer that he donated "an option of sharing equally . . . in all participation in the bank . . ." to Cannon (A. 168).

4. Cannon had actual knowledge of the bank's condition from his own examination of the books on March 2, 1973. See Ex. 10. He already knew the bank had been bought for $100,000, and examined the working books, from which he analyzed the bank in the three pages of Ex. 10. It was he, Cannon, by extracting $100,000 liquid funds and milking the bank, who made certain that the bank was a shell, and he purported to stand aside with a "call" on half the bank, if it flew, and purport to be a bystander if it crashed (A. 162-167).

5. Cannon was not a bystander, but the physical conduit of the corrupt, unsecured loans to known fiduciaries. Defendants' brief has no choice except to seek to support the conclusion of the judge below that the relationship between Rittmaster and Lawrence to plaintiff was not "exclusive" (Defs. Br. 36-38). If this confusion were to persist, it would mean that one dealing with a director of more than one corporation, or an agent for more than one principal, or a trustee of more than one trust could be exonerated by mere plurality of the fiduciary's obligations. Obviously a fiduciary is free to make money in any direction, except in violation of his duty, or multiple duties. Indeed, most fiduciaries have many interests—but the mere statement of an "exclusive" argument contains its own refutation.

6. Defendants' brief fails utterly to deal with Cannon's burden of proof to show exemption under the securities laws.

This brazen fraud is clearly within *A. T. Brod & Co.* v. *Perlow,* 375 F. 2d 393 (2 Cir. 1967). The telephone attempts (A. 79-80) of Schweitzer to certify the check purchasing the certificate of deposit, and the mailing of the certificate of deposit from the Bahamas; the half interest of Cannon in the issuer; the active discussion of the purchase of the certificate of deposit; and the personal loans to fiduciaries of which Cannon was the conduit—all these cast upon Cannot the burden of proving an exemption. We know of no case which has narrowed the application of, or lessened the burden of proof upon, issuers, controlling persons, underwriters and connivers (including any putative "bystanders" having a call on half the stock of an insolvent shell of a foreign issuer). *SEC* v. *Ralston Purina Co.,* 346 U.S. 119. See *Gilligan, Will & Co.* v. *SEC,* 267 F. 2d 461 (2 Cir., 1959); *SEC* v. *Culpepper,* 270 F. 2d 241 (2 Cir.,

1959); *SEC* v. *Continental Tobacco Co. of S. C.*, 463 F. 2d 137 (5 Cir., 1972); *Lewis* v. *Walston & Co., Inc.*, 487 F. 2d 617 (5 Cir., 1973).

Cannon's half interest in the issuer clearly made him a "controlling person" (with one other—Schweitzer) under §15 of the Securities Act of 1933. Likewise, he was an underwriter under §2(11) thereof. He fraudulently sold under Section 10(b) of the Exchange Act of 1934. Cannon violated sections 2(1), 5 and 12 of the 1933 Act. Cannon was a graduate of law school and a stock exchange member, and with his own eyes had personally examined the books of the "A & P Bank", after having bought and milked it.

It is not surprising that defendants should require no less than 17 headings in their "Argument" to obscure the simplicity of this case, thereby making incomprehensible their citation (at p. 19) of *Continental Ore Co.* v. *Union Carbide Corp.*, 370 U.S. 690, where the Court found error in "tightly compartmentalizing the various factual components and wiping the slate clean after scrutiny of each." (699)

Cannon's full participation in the sale of the unregistered security, as well as his animated and sentient conveyor-belt role in the unsecured loans to the fiduciaries, in his own words was (A. 158-160):

> "Q. Mr. Cannon, I show you a further piece of paper [Trial Exhibit 7] which was delivered to us by your counsel with a printed caption at the top 'Memo, Mori Aaron Schweitzer,' addressed to Herb Cannon, 77 Water Street, N.Y.C., N.Y., subject, loan or possible loans, and addressed: 'Herb,' and ask you if that is signed by Mori Aaron Schweitzer?

A. I believe that is his signature, yes.

"Q. Did you receive that memorandum?

A. Yes, I did.

* * * * *

"Q. In what appears to me to be a different handwriting at the bottom there is the word 'delivered 4/23/73.' I ask you if you recognize that writing.

A. That is my secretary's handwriting. Also it is her writing that refers to 25,000 L. Lawrence, 25,000 A. Rittmaster.

"Q. Do you know what this memorandum refers to addressed to Herb and signed by Schweitzer?

A. Yes.

"Q. What does it refer to?

A. It refers to Mr. Schweitzer forwarding to me to forward to Mr. Rittmaster and Lawrence two $25,000 checks which were included, which were loans that they had taken from the A & P Bank.

"Q. What was the occasion for such checks having been sent out?

A. I don't know why he sent them to me rather than sending them direct, but he just did.

"Q. You knew at that time, did you not, that these loans were being made by Messrs. Rittmaster and Lawrence?

A. Yes, I did.

"Q. When did you first learn that these loans were being made?

A. Some time early. I don't recall any dates.

"Q. With whom had you discussed such loans?

A. Mr. Rittmaster, Mr. Lawrence and with Mr. Schweitzer.

"Q. Were those discussions in person?

A. I don't believe so, no.

"Q. But you are sure that you had discussed it with Mr. Lawrence and with Mr. Rittmaster?

A. I believe I discussed it with both of them. At least one of them, but probably both of them.

"Q. Did you at that time notice the nature of the loans?

A. I believe they were to be unsecured.

"Q. That was your belief at the time you discussed it, is that correct?

A. That is correct.

"Q. When was your first discussion with anybody about the subject of the purchase by Aid Auto, the plaintiff in this action, of a certificate of deposit in the A & P Bank?

A. When it was first discussed?

"Q. Yes.

A. I don't recall any exact dates.

"Q. With whom did you first discuss it?

A. Mr. Rittmaster.

"Q. When was that, if you know?

A. I still don't recall any dates. I would say a month or two before that C.D. was actually purchased, whatever that date was.

"Q. Is it your best recollection that you did in fact discuss it with Mr. Rittmaster before the certificate of deposit was purchased in the Atlantic & Pacific Bank?

A. Absolutely.

"Q. Do you know at or about the time the certificate of deposit was purchased that it was in fact purchased?

A. Did I know?

"Q. Yes.

A. Yes."

In the light of Cannon's direct, personal participation in the sale of an unregistered security, there can be no rational basis for characterizing this suit as "frivolous" and awarding counsel fees to defendant.

CONCLUSION

It is submitted that plaintiff-appellant is entitled to the relief requested in the main brief.

Respectfully submitted,

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That of Youth
Heather C. Johnston

April 28, 1975

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